

(iii) Commit any other dollars (e.g., principal and interest repayments, investment earnings) taken for loan subsidies to projects over the same time period during which binding commitments are made for the capitalization grant from which the allowance was taken.

(3) A State may extend the term for a loan to a disadvantaged community, provided that a recipient completes loan repayment no later than 30 years after project completion and the term of the loan does not exceed the expected design life of the project.

(c) *Refinance or purchase of local debt obligations*—(1) *General*. A State may buy or refinance local debt obligations of municipal, intermunicipal, or interstate agencies where the debt obligation was incurred and the project was initiated after July 1, 1993. Projects must have met the eligibility requirements under section 1452 of the Act and this subpart to be eligible for refinancing. Privately-owned systems are not eligible for refinancing.

(2) *Multi-purpose debt*. If the original debt for a project was in the form of a multi-purpose bond incurred for purposes in addition to eligible purposes under section 1452 of the Act and this subpart, a State may provide refinancing only for the eligible portion of the debt, not the entire debt.

(3) *Refinancing and State match*. If a State has credited repayments of loans made under a pre-existing State loan program as part of its State match, the State cannot also refinance the projects under the DWSRF program. If the State has already counted certain projects toward its State match which it now wants to refinance, the State must provide replacement funds for the amounts previously credited as match.

(d) *Purchase insurance or guarantee for local debt obligations*. A State may provide assistance by purchasing insurance or guaranteeing a local debt obligation to improve credit market access or to reduce interest rates. Assistance of this type is limited to local debt obligations that are undertaken to finance projects eligible for assistance under section 1452 of the Act and this subpart.

(e) *Revenue or security for Fund debt obligations (leveraging)*. A State may use

Fund assets as a source of revenue or security for the payment of principal and interest on revenue or general obligation bonds issued by the State in order to increase the total amount of funds available for providing assistance. The net proceeds of the sale of the bonds must be deposited into the Fund and must be used for providing loans and other assistance to finance projects eligible under section 1452 of the Act and this subpart.

§ 35.3530 Limitations on uses of the Fund.

(a) *Earn interest*. A State may earn interest on monies deposited into the Fund prior to disbursement of assistance (e.g., on reserve accounts used as security or guarantees). Monies deposited must not remain in the Fund primarily to earn interest. Amounts not required for current obligation or expenditure must be invested in interest bearing obligations.

(b) *Program administration*. A State may not use monies deposited into the Fund to cover its program administration costs. In addition to using the funds available from the administration and technical assistance set-aside under § 35.3535(b), a State may use the following methods to cover its program administration and other program costs.

(1) A State may use the proceeds of bonds guaranteed by the Fund to absorb expenses incurred issuing the bonds. The net proceeds of the bonds must be deposited into the Fund.

(2) A State may assess fees on an assistance recipient which are paid directly by the recipient and are not included as principal in a loan as allowed in paragraph (b)(3) of this section. These fees, which include interest earned on fees, must be deposited into the Fund or into an account outside of the Fund. If the fees are deposited into the Fund, they are subject to the authorized uses of the Fund. If the fees are deposited into an account outside of the Fund, they must be used for program administration, other purposes for which capitalization grants can be awarded under section 1452, State match under sections 1452(e) and (g)(2) of the Act, or combined financial administration of the DWSRF program

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and CWSRF program Funds where the programs are administered by the same State agency.

(3) A State may assess fees on an assistance recipient which are included as principal in a loan. These fees, which include interest earned on fees, must be deposited into the Fund or into an account outside of the Fund. If the fees are deposited into the Fund, they are subject to the authorized uses of the Fund. If the fees are deposited into an account outside of the Fund, they must be used for program administration or other purposes for which capitalization grants can be awarded under section 1452. Fees included as principal in a loan cannot be used for State match under sections 1452(e) and (g)(2) of the Act or combined financial administration of the DWSRF program and CWSRF program Funds. Additionally, fees included as principal in a loan:

(i) Cannot be assessed on a disadvantaged community which receives a loan subsidy provided from the 30 percent allowance in § 35.3525(b)(2);

(ii) Cannot cause the effective rate of a loan (which includes both interest and fees) to exceed the market rate; and

(iii) Cannot be assessed if the effective rate of a loan could reasonably be expected to cause a system to fail to meet the technical, financial, and managerial capability requirements under section 1452 of the Act.

(c) *Transfers.* The Governor of a State, or a State official acting pursuant to authorization from the Governor, may transfer an amount equal to 33 percent of a fiscal year's DWSRF program capitalization grant to the CWSRF program or an equivalent amount from the CWSRF program to the DWSRF program. The following conditions apply:

(1) When a State initially decides to transfer funds:

(i) The State's Attorney General, or someone designated by the Attorney General, must sign or concur in a certification for the DWSRF program and the CWSRF program that State law permits the State to transfer funds; and

(ii) The Operating Agreements or other parts of the capitalization grant

agreements for the DWSRF program and the CWSRF program must be amended to detail the method the State will use to transfer funds.

(2) A State may not use the transfer provision to acquire State match for either program or use transferred funds to secure or repay State match bonds.

(3) Funds may be transferred after one year has elapsed since a State established its Fund (*i.e.*, one year after the State has received its first DWSRF program capitalization grant for projects), and may include an amount equal to the allowance associated with its fiscal year 1997 capitalization grant.

(4) A State may reserve the authority to transfer funds in future years.

(5) Funds may be transferred on a net basis between the DWSRF program and CWSRF program, provided that the 33 percent transfer allowance associated with DWSRF program capitalization grants received is not exceeded.

(6) Funds may not be transferred or reserved after September 30, 2001.

(d) *Cross-collateralization.* A State may combine the Fund assets of the DWSRF program and CWSRF program as security for bond issues to enhance the lending capacity of one or both of the programs. The following conditions apply:

(1) When a State initially decides to cross-collateralize:

(i) The State's Attorney General, or someone designated by the Attorney General, must sign or concur in a certification for the DWSRF program and the CWSRF program that State law permits the State to cross-collateralize the Fund assets of the DWSRF program and CWSRF program; and

(ii) The Operating Agreements or other parts of the capitalization grant agreements for the DWSRF program and the CWSRF program must be amended to detail the method the State will use to cross-collateralize.

(2) The proceeds generated by the issuance of bonds must be allocated to the purposes of the DWSRF program and CWSRF program in the same proportion as the assets from the Funds that are used as security for the bonds. A State must demonstrate at the time of bond issuance that the proportionality requirements have been or will be met. If a default should occur, and the

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Fund assets from one program are used for debt service in the other program to cure the default, the security would no longer need to be proportional.

(3) A State may not combine the Fund assets of the DWSRF program and the CWSRF program as security for bond issues to acquire State match for either program or use the assets of one program to secure match bonds for the other program.

(4) The debt service reserves for the DWSRF program and the CWSRF program must be accounted for separately.

(5) Loan repayments must be made to the respective program from which the loan was made.

§ 35.3535 Authorized set-aside activities.

(a) *General.* (1) A State may use a portion of its capitalization grants for the set-aside categories described in paragraphs (b) through (e) of this section, provided that the amount of set-aside funding does not exceed the ceilings specified in this section.

(2) A State may not use set-aside funds for those projects or project-related costs listed in § 35.3520(b), (c), (e), and (f), with the following exceptions:

(i) Project planning and design costs for small systems; and

(ii) Costs for restructuring a system as part of a capacity development strategy.

(b) *Administration and technical assistance.* A State may use up to 4 percent of its allotment to cover the reasonable costs of administering the DWSRF program and to provide technical assistance to public water systems.

(c) *Small systems technical assistance.* A State may use up to 2 percent of its allotment to provide technical assistance to small systems. A State may use these funds for activities such as supporting a State technical assistance team or contracting with outside organizations or other parties to provide technical assistance to small systems.

(d) *State program management.* A State may use up to 10 percent of its allotment for State program management activities.

(1) This set-aside may only be used for the following activities:

(i) To administer the State PWSS program;

(ii) To administer or provide technical assistance through source water protection programs (including a Class V Underground Injection Control Program), except for enforcement actions;

(iii) To develop and implement a capacity development strategy; and

(iv) To develop and implement an operator certification program.

(2) Match requirement. A State must provide a dollar for dollar match for expenditures made under this set-aside.

(i) The match must be provided at the time of the capitalization grant award or in the same year that funds for this set-aside are expected to be expended in accordance with a workplan approved by EPA.

(ii) A State is authorized to use the amount of State funds it expended on its PWSS program in fiscal year 1993 (including PWSS match) as a credit toward meeting its match requirement. The value of this credit can be up to, but not greater than, 50 percent of the amount of match that is required. After determining the value of the credit that it is eligible to receive, a State must provide the additional funds necessary to meet the remainder of the match requirement. The source of these additional funds can be State funds (excluding PWSS match) or documented in-kind services.

(e) *Local assistance and other State programs.* A State may use up to 15 percent of its capitalization grant to assist in the development and implementation of local drinking water protection initiatives and other State programs. No more than 10 percent of the capitalization grant amount can be used for any one authorized activity.

(1) This set-aside may only be used for the following activities:

(i) A State may provide assistance only in the form of loans to community water systems and non-profit non-community water systems to acquire land or conservation easements from willing sellers or grantors. A system must demonstrate how the purchase of land or easements will protect the source water of the system from contamination and ensure compliance with national primary drinking water regulations. A State must develop a